RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Jan. 3, 1996 **LETTER 1190**

Dec. 22 DJIA 5097.97; PTI 4388; A-D Ratio -2.38
Dec. 29 DJIA 5117.12; PTI 4404; A-D Ratio -1.64
Dow Yield: 2.30%; Dow Price/Earnings: 15.6
Dow 200-day MA: 4633; Dow 30-day MA: 5097
Dow Times Book Value: 3.92; PTI 89-day MA: 4309
Percentage of Undervalued Blue-chips: 4%
Gold 200-day MA: 387.10; Gold-PTI: 591

THE PICTURE: I drew attention to the *weakening* Transportation Average in the last Letter. And I reminded subscribers that the Transportation Average is the Average that reflects the *sales and transport and travel capabilities* of the nation. The high for the D-J Transportation Average was recorded on December 5 at **2092.11.** Since then, the Transports have been in a slump. As this is written, the Transportation Average is 132 points below its December 5 high and still looking weak. Is something strange going on?

The above prompts me to ask the following questions: has the stock market (with particular reference to the blue-chips) been off on a fantasy-flight of its own? Is a recession creeping into the economy, and is it only the Transports that are aware of it? In view of the huge infusion of liquidity that the Fed has pumped into the economy over the past five years -- has inflation simply moved from the economy to the stock market?

The mystery deepens (see montage below). For while the stock market has been heading higher, the economy has hardly been exuberant. Along those lines, listen to this from the December 19 report from former *Barron's* writer, John Liscio [*The Liscio Report,* (201) 509-2256]: *"Just this past weekend I walked into a store to buy Christmas lights and was given 50% off. A store a friend visited in Chicago had its entire Nintendo line reduced by 50%. Last Thursday, Venture Stores, a Midwest discounter, started offering free merchandise to one in every 100 shoppers. Each passing day brings news of earnings disappointments at a flock of new companies. And virtually no industry is immune. The inventory/sales ratio just hit a new two-year high. Kimberly Clark, Scott Paper and Polaroid just handed out some 17,000 pink slips, while recent mergers are creating thousands more . . . Capacity utilization has fallen in nine of 11 months this year, consumer prices were unchanged last month, the first time that's happened since the last recession, and Macy's is making sales clerks forego half of the commissions they earn in the five-week holiday season."* **Russell Comment:** Does that sound like a rosy scenario? Or am I being too cynical?

MARKET ACTION: The only people who love big market breaks are the short sellers. Nevertheless, big market breaks serve a very useful purpose. Market breaks allow us to gauge the strength or weakness of the market, and they allow us to identify or re-confirm the underlying trend.

Sales of Existing Homes Fall For 2d Consecutive Month

WASHINGTON, Dec. 27 (Reuters) — Sales of existing homes fell for a second consecutive month [illegible] After a strong third quarter in which the gross domestic product rose at a vigorous 4.2 percent annual

Budget Rent A Car Lays Off Workers, Alters Top Ranks Amid Industry Slump

By GABRIELLA STERN
Staff Reporter of THE WALL STREET JOURNAL

DETROIT — **Budget Rent A Car Corp.,** coping with sagging profits amid an indus- [illegible] owned by Chrysler Corp., have reorganized in the past year as the auto maker readies them for sale. Thrifty recently pulled out of the busy south Florida market. In Hawaii, Dollar is buying out its

RETAILERS REPORT A SHOPPING SEASON WORTH FORGETTING

BLEAK FORECAST FOR 1996

Even Stores That Sold Volume Had to Cut Profit Margins to Draw in Customers

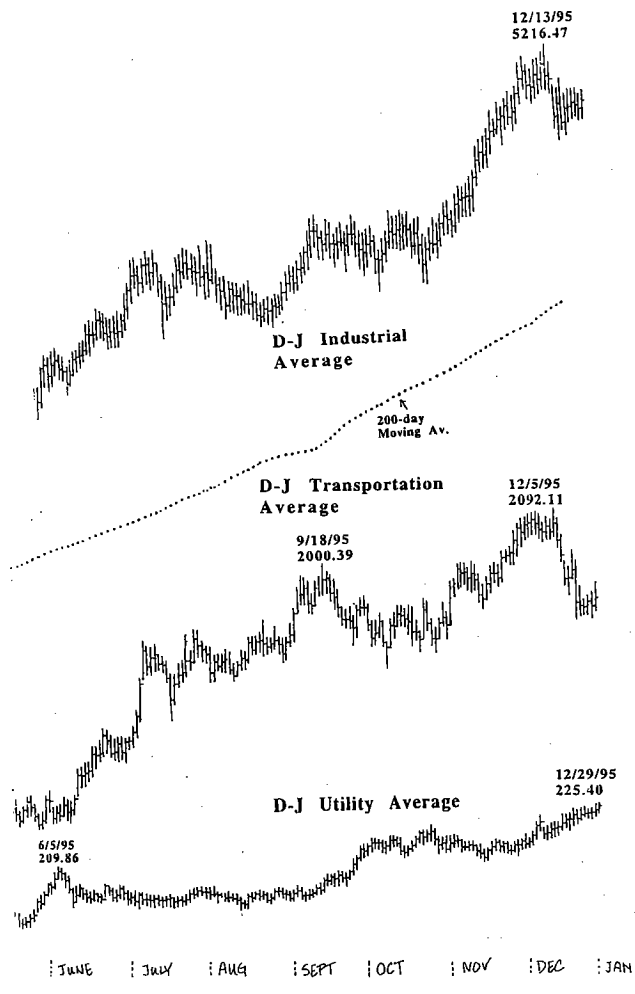
Tool Orders Fall, New Hint Of a Slowdown

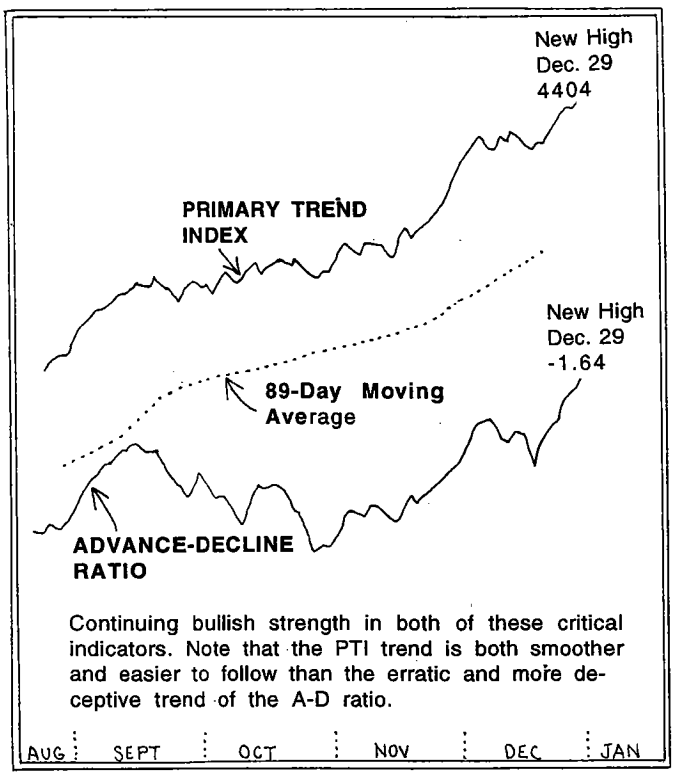
By The Associated Press

Orders for American-made machine tools fell in November, the first drop in two months, an industry trade group said yesterday, in a report that suggested further weak-

Brokerage-House Stocks Fizzle After Long Run-Up

PLOP, plop. Fizz, fizz. No doubt many investors holding stocks of brokerage houses are [illegible] good fortune should continue, at least through the first half of 1996 and perhaps until after the Presiden-





For instance, on the recent decline, the D-J Industrial Average on December 20 recorded a low close of **5059.32.** However, the Transportation Average continued to decline. By December 28, the Transports had recorded a low close of 1960.67. At the time this is written, I can't tell whether that represents the low for the Transports. Assuming that it is, as long as ONE OR BOTH Averages hold above these levels, the trend must be classified as bullish.

The Coming Test: Will BOTH Averages recover to new bull market highs? The upside targets are clear -- Transports, a high close (Dec. 5) of **2092.11**, and Industrials, a high close (Dec. 13) of **5216.47.** If both Averages can close above those highs, the market will have given us another "all-clear" signal. However, a failure of one or both Averages to better those high closing levels will spell potential trouble.

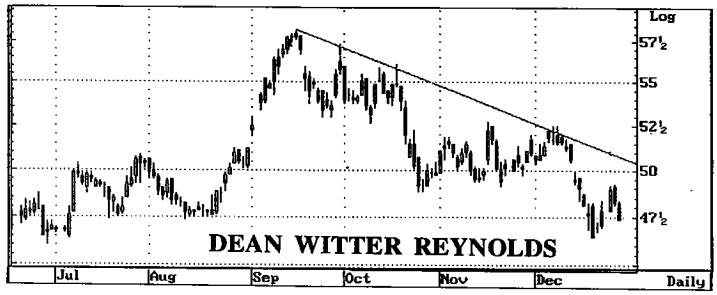
As a matter of interest, the December decline in the Dow amounted to a drop (on a closing basis) of only 3.0%. Thus, we have the amazing record of the Dow not having suffered a decline of as much as 4% all year. It's never happened before. Even more incredible, the Dow (closing basis) hasn't suffered as much as a 12% correction over the last five years. Confirmed bears believe that the market is "saving" its ammunition for "the big one on the downside."

With it all, a certain amount of subtle deterioration has crept into the market. This is not unusual, considering current valuations and considering the current level of bullishness. I watch many areas for evidence of strength or weakness. Here are a few studies that I want to discuss.

(1) The **percentage of stocks holding above their 200-day moving average.** This is actually a variation of the breadth studies. The percentage holding above their 200-day moving average hit a recent high of **78.5%** on September 12. Following that, the percentage dropped to 61% at the end of October. Then during December the percentage climbed back to 67%. But on December 18 the percentage sank to a new low of 60%. This indicates deterioration in the main body of NYSE stocks. The latest percentage shows a rise back to 64%, but this is a far cry from the earlier 78.5%. **Observation:** 36% of NYSE stocks (a little over one-third) are struggling, despite the strength in the blue-chips.

(2) **Investor's Business Daily Mutual Fund Index** is well worth following, and I've included it in recent Letters. This is a composite of 20 leading growth mutual funds. Since a massive portion of the public's money is now in mutual funds, this Index tells us a lot about how the public is faring. At the latest reading, the Mutual Fund Index was up 33.7%.

(3) The third area is one I alluded to in the last Letter. It is the **brokerage stocks.** As a group they've been hit hard. The brokerage community has a way of sensing what lies ahead for stocks. Remember, in a bull market, with volume expanding, the brokers make money; in a bear market, with volume tending to contract, the brokers face tough times.



(4) The **Transports** tend to reflect the sales and shipping capabilities of US corporations. Since airline stocks are now included in the Transportation Average (along with truckers and rails), the Transportation Average also reflects the trend of travel and tourism. Finally, the stocks in the Transportation Average tend to be heavily leveraged, so that the Transportation Average is also quite sensitive to interest rates. For these reasons, I always watch the action of the Transports. And of course the Transports constitute one-half of the Dow Theory.

The Transports have been weaker than the Dow recently. And as you well know, non-confirmations on the downside are a sign of strength, while upside non-confirmations are a sign of weakness.

On December 18 the Transportation Average gapped down (a gap in an average is unusual), and it constituted (at least in my experience) a strong indication of weakness.

JANUARY: Last weekend I went through the history of the Averages going back to 1885. And I was struck by how many times the month of January has ushered in trouble. Since 1885 seven bear markets have started in January. Since 1885 there have been 24 instances of important reactions or sell-offs starting in January. The most recent January declines have occurred in 1962, 1968, 1970, 1973 (bear market), 1977, 1982 and 1984. With the general market being sloppy here at year-end and with the Transports being weak at the end of 1995, it would not shock me to see trouble entering the picture during January 1996.

Question: The Fed said it would reduce rates IF a balanced budget agreement was passed. So why did the Fed jump the gun and reduce the Fed Funds rate BEFORE a balanced budget agreement was passed? My opinion: (1) the Fed is nervous about the sluggish economy and wants to give it a boost, and (2) the Fed wants to keep the markets floating up or holding up -- particularly with the '96 election coming up.

PRIMARY TREND: The primary trend is the *single greatest force* in the market. If the primary trend is bullish (which it has been and continues to be), then the broad, long-term direction of the market is UP. But important -- if the primary trend is bullish, then any market decline can quickly lead to an oversold situation. And when that happens, when a bull market becomes oversold, then the downside action stops abruptly. It's as if the brakes were slammed on.

The other side of the coin -- when the primary trend is bearish, declines tend (obviously) to be far more serious. When the bear is in command, the market can decline and appear oversold. But an oversold condition in a bear market can be very deceptive. In a bear

market the market can *remain oversold* for many weeks and at times (remember 1973-74) for many months.

Thus, I am always extremely interested in HOW the market acts after a steep decline. To repeat, in a bull market, a steep decline should end with a solid bottom. BUT in a bear market, a steep decline may quickly degenerate into an even steeper decline and then into a bone-chilling collapse. When the primary trend is bearish the market acts as though it has no downside brakes. It just keeps dropping -- and sliding -- until it reaches the exhaustion point.

CONCLUSION: The trend of the market is bullish. Furthermore, we will take it to remain bullish until PROVED otherwise. Important (see page 2 chart), my **Primary Trend Index** continues to record new highs. But two comments: (1) Beware the "Goblins of January." And (2) I don't like the Transport action.

INVESTMENT POSITION: The bull stays in the box. But (1) with only 64% of all NYSE holding above their 200-day moving average, (2) with only 4% of 350 blue-chips classified as "undervalued" (as per *IQ Trends* in La Jolla), (3) with the Dow yielding a minute 2.30% and (4) with this market literally uncorrected for years, it might pay to be careful, mighty careful. They say "cash is trash." Don't believe it.

AFTER THE BIG ONE? One important question is, "What can we expect of the market following a huge rise?" You may think the answer is, "After a big rise there's automatically a big fall." But the answer depends largely on whether the primary trend of the market remains bull or bear.

Let's take a few examples. The greatest single-year rise in stock market history occurred in 1915. The Dow was up 81.6% that year. The year 1916 opened with a 13% Dow drop, but this was followed by a 42% surge to year end. I call the 1915 high to 1916 low a bear market. The move up in 1916 was the start of a new bull market.

The second greatest rise occurred in 1933, a Dow rise of 66.7%. It occurred during a continuing bull market. In early 1934 the Dow sank 25%, then headed up and continued up to the final bull market peak recorded in March 1937.

The third largest Dow rise occurred in 1928, a rise of 42.2%. This was followed by a further big Dow rise to the September 3, 1929 high. That marked the bull market peak, and you know what happened after that.

The fourth greatest Dow rise, 46.6% in 1908, was followed by a continuing advance throughout 1909. A big bull market was in progress.

The fifth biggest rise occurred in 1954, a year which saw the Dow advance 43.6%. This was followed in 1955 by a further big rise. A powerful bull market was continuing in force.

I could go on and on, but the conclusion is that there is no automatic formula for action following a major Dow rise. If a bull market is still in force, the odds are that the year following the rise will be fair to good, but possibly erratic. If the big rise occurs during a bear market or just prior to a bear market then you can look for trouble during the following year.

To bring the matter to the present, if the current huge advance proves to be the final advance for the bull market, then obviously, we can prepare for major trouble, probably in '96. But if what we're seeing is an advance in a *continuing* bull market, then at worst all we can expect is a correction or erratic, choppy action in '96, possibly carrying over to '97.

My own guess is that the current advance could easily wind up this bull market. At December 13th's record Dow high of 5216.47. the Dow was selling at **44.4 times dividends.** That incredible ratio must be discounting a truck-full, no an ocean-full of fabulously bullish news. (The yield at Dow 5216.47 is an amazingly low **2.25%.**)

NOTES & QUOTES: What Contract? Remember the GOP's "Contract With America"? Do you wonder what ever happened to it? Here's what -- of the 21 provisions, only three relatively minor items have become law. Term limits and a balanced-budget amendment lost out. Winner -- bigger defense spending. As for half of the rest, Clinton vetoed them when he did a "hands-down" on the budget. For the remainder, they're in a very gray area as the Senate and the House debate them. As for the promised closing of government departments and agencies, only one has been closed, the Interstate Commerce Agency.

* *

Politics is another word for irony. Clinton ran on a program of "change," but he's fought tooth and nail against anything that hints of real change, particularly any change to smaller or less government. The truth is that Clinton is the "Status Quo President." But those of us who have had enough of the Clintons aren't worried because we know that Clinton is left-handed and therefore doomed. In the history of the US there have been four other left-handed presidents -- James Garfield, Harry Truman, Gerald Ford and George Bush. None has been re-elected.

Surprise: in the last 164 years *only two* Democratic presidents were re-elected to a second term. Wilson was re-elected in 1916 and Roosevelt was re-elected in 1932 (during the Depression). During the same period six Republican presidents were re-elected. If Clinton is re-elected, he'll be only the third Democrat to be re-elected since 1830.

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The World Wide Web is the graphics part of the Internet, and maybe the most interesting part. And it's the part that everybody wants to get on to. Yahoo is the electronic guide to the Internet. How hot is the Web? Yahoo gets 3,000 (that's three thousand) submissions to be listed on the Net every day!

* *

Netscape and its competitors have created millionaires (via the stock market) by the car-full. In fact (get this) you can track these guys on an Internet Millionaires home page.

* *

Subscribers wonder why I don't treat Bill Gates ("America's richest man") kindly. The answer: I'm suspicious of guys whose ambition is world-domination. The following are excerpts from the Dec. 24 *NY Times* review of Gates' new book, "The Road Ahead" (Viking, $29.95): "'The Road Ahead' is little more than a positioning document, sold in book form with an accompanying CD-ROM and designed mainly to advance the interests of the Microsoft Corp . . . None of this should be very surprising, even if it is disappointing. After all, there is little Mr. Gates has done in his relatively young life that has not been aimed at advancing the interests of the Microsoft Corp. Ever since he dropped out of Harvard to found the company some 20 years ago, he has been maniacally focused not just on having Microsoft do well but on having it dominate its industry . . . While users of the Internet are enthralled by the fact that so much of the information floating around cyberspace is free, Mr. Gates takes solace from his belief that it can't last. 'Over the next several years,' he writes, 'there will be new billing options -- monthly subscriptions, hourly rates, charges per item accessed and advertising payments -- so that more revenue flows to the information providers' . . . So what's keeping Mr. Gates awake right now? The answer to that question is not only obvious, it's the real reason 'The Road Ahead' was written in the first place. The answer is the Internet. It has the potential to transform the nature of the computer business, to create a whole new set of corporate winners and losers. And for all his business savvy, Mr. Gates has been caught flat-footed by its sudden emergence."

* *

The Dreamworks guys (you know, Spielberg, Geffen and Katzenberg) have taken a huge complex at Playa Vista on LA's Westside. But Hollywood itself is becoming less and less important to the entertainment business. This from the *LA Times:* "Once the center of the entertainment world, Hollywood is increasingly a shadow of its historic self, known more for its runaways, prostitutes and high crime rate than as a show business hub."

As for Hollywood, the high cost of putting out a film (average cost is now $50 million) is rendering movie-making more of a crap-shoot than a business. The list of recent expensive pics that have lost money goes on and on. No wonder Hollywood's Japanese investors and owners are growing increasingly nervous.

* *

Speaking of nervous, in 1995 doctors' incomes took their first significant drop in 30 years. In 1994 physicians' income dropped to $150,000, down 4% from '93. It's the HMOs that are doing it -- they're forcing doctors to lower their fees. As for docs on their own, the ever-increasing cost of running a medical office, paying salaries, processing claims and buying supplies hurts, hurts, hurts. Gee, when I was a kid and you had a high fever, the family doctor would be over at the house within an hour or so. Those were the days when all a doc had to do was practice medicine. His nurse or wife would send you a hand-written bill at the end of the month.

* *

You buy a computer, and two months later it's an antique. Get this -- Samsung, the giant S. Korean conglomerate, announced that it's the first company in the world to complete the prototype circuit design for the newest generation of computer memory chips. A single chip, 1Gb Dram, about the size of a thumbnail, will be able to store up to 15 minutes of moving pictures, 16 hours of sound, 400 still pictures, 8,000 newspaper pages or approximately 160 books. The new chip is expected to become a key component in computers because of its huge memory -- about 16 times that of the highest capacity Drams today.

By the way, Samsung is on its way to becoming one of the super-giant corporations of the world, making everything from chips to cars. Samsung's projection for chip sales in the next few years -- $12 billion a year. Microsoft dreamed of taking over the world. Samsung may do it.

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I was a bit startled by this headline. Gosh, Dow 10,000 by the year 2,000. Reminds me of November 1974, during the big bear market when the Dow had collapsed to around 600. A number of analysts came out saying that the Dow was "going to be cut in half, down to 300 at least." That kind of nutty pessimism was a sign that the bottom was near. Sure enough, Dow 577 was the low recorded in December. So, of course, Dow 10,000 had me wondering again. When a well-known analyst screws up enough courage, following a huge bull move, to predict a doubling of the Dow with the Dow yield now at a minuscule 2.25%, well, as I said, it has me wondering.

Yardeni Says 10,000 Dow By 2000

From page 1

So I think the market's pretty dangerous here over the next six months. Fourth-quarter earn-

Yardeni: I think the biggest risk to the stock market is that people really lose their confidence in the technology story. And we certainly have enough speculative hype to sound some typical contrary warning alarms.

* *

At least they have a name for it. The new unified European currency will be called the Euro. Seven out of 10 of the top executives of Europe's largest corporations want a single currency and also want the European union. Ah, but there are troubles. To join, the various nations need to adhere to strict rules as to debt, deficits, etc. And already France has its hands full. You see, the French populace wants to keep all those welfare goodies, but the French government wants to tighten the nation's belt and join the Euro. Meanwhile, French unemployment has hit 12%, and the protest parades are hitting the French streets. Will Europe unite? Will European nations tighten their belts? It's a big, big question. The Russell guess: even if the Euro (a single currency) comes into being, the other major European currencies will still be used (for instance, I can't see the Germans giving up the D-mark for the Euro).

* *

Diamonds: DeBeers (they control 80% of all diamond sales) announced that sales of the stones were up 6.6% this year -- to a record $4.5 billion. The US accounts for about one-third of all diamond purchases; Japan accounts for one-fifth. Interestingly, small diamonds are increasingly common, while large (over three carats) gem quality stones are increasingly rare.

* *

Here in the US we have to wonder about our workers, who are being decimated (job-wise) by the advent of computers and the corporate desire for profits and productivity. An interesting bit of information: the highest percentage of union membership was in 1945 when 35.5% of the US workforce was unionized. Since then membership has been sinking. Union membership is now about 15.5% of the workforce.

* *

In 1982, there were 777 mutual funds in existence. At the end of 1994, there were 5,400 mutual funds. This represents an increase of 695% . Yep, Wall Street makes money the old, old-fashioned way --- they "follow the money."

* *

The following is from *The Richebacher Letter* [(800) 894-3424]: "What is it that causes us to rate the Wall Street boom a bubble? Simply put, the financial boom flies in the face of the extreme paucity of new savings in the US. The acid test of any bubble is the relationship between available savings and the total flow of funds into the market. As we have repeatedly explained, the money pouring into the US markets comes from various sources, but least of all from genuine savings. Most of it arises from two extraordinary sources: a race out of money into securities, and protracted credit creation vastly in excess of current income and GDP. The first makes for a money bubble, the other one for a credit bubble . . . Every bubble is vulnerable to money tightening . . . The implicit danger of any bubble is that it creates an illiquid, and therefore highly vulnerable, financial structure . . . We think the Fed, freed from external discipline by the foreign central banks who prop up the dollar, is desperate to keep the money and credit bubbles afloat forever with monetary looseness."

* *

This from *Market Logic* [(800)442-9000]: "To hear its technical champions explain it, the Internet is nothing less than the most significant development in American business and culture since the emergence of the personal computer, and perhaps even since IBM commercialized main frames 35 years ago. Cultural analysts go even further, suggesting that the Internet rivals radio and television in terms of its ultimate impact on society and lifestyle. While perhaps true, the powerful rhetoric usually obscures any meaningful explanation of just *why* this is so. The reason is that, quite simply, the Internet lets people use their computers in ways that they have heretofore only dreamed of. Searching a database of national names and addresses to find a long-lost friend, for example. Comparison shopping for music CDs at dozens of stores at the push of a single button. Purchasing and obtaining commercial-grade computer software *instantly,* rather than going to a computer store. Searching all of the computers in the world for hard-to-find information such as 'hummingbird migration patterns in Peru' . . . The true power of the Internet is its capability for one-to-one connectivity with every computer that is connected to it."
Russell comment: I agree with the above, but many questions also arise. How will the Internet impact on the retail business? How will it affect publishing? Can the Post Office survive the Internet? The questions are as endless as the possibilities and opportunities the Internet offers. And remember, the whole thing is still in the early, experimental stage, probably comparable to television in the late '40s.

* *

History: I bought my first TV set around 1949. It cost me $450, equal to about $2,500 today. It was a big, ugly wooden box with a tiny screen that measured around four inches high by six inches across. I was living in NYC in an apartment building, and when the neighbors heard that I had an actual TV they flocked in to see the miracle. The big event in those days was Tuesday night and the Texaco Theater with Milton Berle. On Tuesday night the nation

came to a stop. Every one with a TV set sat fascinated as Uncle Miltie did his thing. Incredibly, today, 45 years later, Miltie is still performing. Milton and George Burns, they go on seemingly forever.

* *

Giving money to charities? It's always interesting to know what percentage of your gift goes to the actual program and what goes to the administrators. Believe me, it can vary. For instance Catholic Charities USA show that a big 90.2% goes to the program. Some others: Amer. Red Cross -- 91.9%; Salvation Army -- 86.2%; Goodwill -- 84.0%; United Cerebral Palsy -- 85.8%. Now check these: American Cancer Soc. -- 72.3%; Nature Conservancy a low 60.5%; Special Olympics Int. -- 64.9%; Shriners Hospital for Crippled Children -- 57.7%; National Gallery of Art -- 59.5%.

* *

When you "throw off your mortal coil," the government moves in and grabs as much as they can of your estate. If your estate is big, the bite is also big. One of the best ways of "beating big Uncle" is to give the money away. Your government allows you to give a $10,000 gift (each year) to as many people as you like; $20,000 if you and your spouse give. Also, a corporation can pay tuition to a school or college if the tuition-gift is made out *directly* to the school or college (you cannot give the gift to the person and then direct them to give the gift to the school).

* *

Marc Faber's *Gloom, Boom and Doom Report* out of Hong Kong is one of my favorites (852-2801 5410). Marc is an inveterate traveler, and his observations are always fascinating. Fresh from a Morgan Stanley conference in the Bahamas, Marc reports that John Templeton believes "inflation is inevitable" because of "our Democratic political process which, in the long run, will always favor the money printing press at the expense of monetary and fiscal discipline." Then Marc flies to NYC where he keenly observes, "If there is currently one boom city in the world it is New York. The hotels are full (it was quite different two years ago), its traffic is almost like that of Bangkok, the best and 'in' restaurants are once again packed (the favorite subject is, of course, the stock market and the Internet stocks), and the city is being invaded by Europeans who find NYC to be a bargain. My experience with emerging economies has taught me to be extremely wary of their stock markets when the business capital is booming. Good entry points into emerging markets occur when the hotels are empty (three years ago one could walk into any NY hotel and bargain for a room), when few foreigners are visiting, and when business sentiment is depressed (now the case in Japan). But today the mood in Manhattan matches a temperament that could only be otherwise produced by swallowing a huge ecstasy pill; the European 'jet set' who, two years ago, were on a regular pilgrimage to Asia in search of investment opportunities (in China -- where else?) are now in the Big Apple playing the US stock and bond markets and looking for all kind of deals. I am fully aware that the NY economy is not necessarily representative of the US, but in my opinion NY is likely to experience high inflation in the next 12 months unless the boom comes to a sudden end! In any event, if business in NY was even remotely a benchmark for the American economy, about the last thing one would wish to own would be a 30-year US T-bond yielding around 6%." **Russell Comment:** Sophisticated observations and that man can write. I was particularly interested in Marc's comments about Japan because I own a batch of Nikkei 20,000 warrants (meaning that I think the Nikkei could go half way back to its high, which could take it to around 24,000 -- the Nikkei is just under 20,000 now).

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Yesterday (Dec. 21) I walked along the beach, then stopped to watch the "beachies" and the surfers. Maybe it takes a former Easterner to admire and wonder at the sight of a bunch of kids in December playing in the sand or pushing out to sea on their surf boards. Here it is in La Jolla, around 70 degrees and sunny, and I know what it feels like in my old home town of Nooo Yawk -- c-o-l-d. My 17-year-old son, Ryan, is a surfer, and to tell the truth -- that amazes me. I was never much of a swimmer (my sport was track). But in 1942, as a freshman at Rutgers in New Jersey, I decided that I really wanted to learn how to swim. Rutgers had one of the best swim teams in the nation, and I would go over to the pool and watch, fascinated, as the Rutgers coach worked with his champion swim team. Then when nobody was around I'd get in the pool and practice what I learned. It worked, and I became a fairly decent swimmer.

* *

From the *Bank Credit Analyst's* year-end "Outlook for 1996" [(514)499-9706]: "The strong performance of the US financial markets this year has been extremely frustrating for those who hold a very orthodox (i.e., 19th century Austrian) view of what makes an economy successful. For example, the US has a low savings rate, a large current account deficit, debt-addicted consumers and a long-run downtrend in its exchange rate. These aspects of the US contrast sharply with the high savings, firm exchange rates and healthy trade accounts of the hard-currency European countries and, as a result, many foreign investors have shunned dollar assets . . . The US government deficit as a share of GDP currently is the smallest of any industrialized country, and the US also has the lowest tax burden. Moreover, despite the recent disgraceful political games and brinkmanship in Washington, current budget negotiations will likely lead to a deal that significantly lowers the deficit during the next decade. In contrast, Japan's budget deficit is soaring, and most European countries are stuck with both large deficits and high taxes . . . Throughout the past few years, there has been a unique symbiotic relationship between the US and the rest of the world. The US has provided a growing market for global exports while the rest of the world has financed an expanding US current account deficit. This has been to everyone's advantage. The US has acted as a locomotive for a sluggish world economy while foreign investors, and most importantly, central banks have purchased dollars, helping to sustain the bull market in US assets."

* *

Beaten down by adversity? The sky falling down on you? Don't give up. Check this out -- in games last year and this, the San Diego Chargers have come from behind to win 18 of 22 games. Last year the Chargers, picked by all the experts to end up last in their division, went to the Super Bowl. This year, from a dismal 4-7 start, the Chargers ended the season 9-7, winning their last five games and going to the playoffs.

* *

LATEST FROM CHINA: China is genuinely worried about smoking and cancer. Half of all China's adult men are smokers. China is the world's largest tobacco producing and consuming country, and the number of Chinese smoking is estimated to be increasing at the rate of 2% a year. Starting in mid-1996 Beijing has banned all smoking in enclosed public places. Individuals violating the ban will be fined 10 yuan ($1.20).

How about the Chinese stock market (which everyone was trying to get into a year or so ago)? Of the 17 China-based companies now listed on the Hong Kong Exchange, only one, Shanghai Petro-chemical, trades at more than its original price. For instance, Brilliance China Automotive Holding, China's first stock to list on the NYSE, shot up to 30 after it debut, but it now trades at around 4. What's the problem with China's stocks? Scanty disclosures, high taxes, tight credit policy, and the stocks were badly priced to begin with.

* *

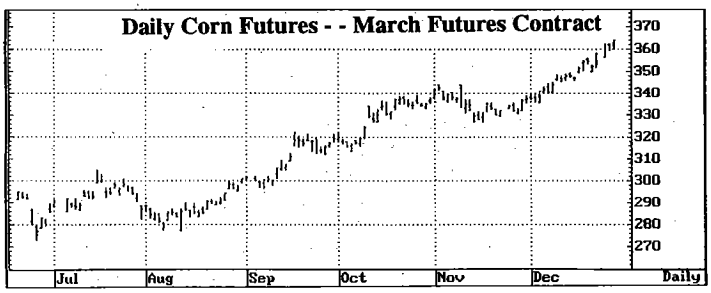
Goldman Sachs, one of the great still-private Wall Street companies and one of the smartest, is kicking around the idea of going public. Why? The firm feels it needs more capital. But you have to wonder whether Goldman doesn't think that the stock market is ripe for sellers. Even the hold-out private companies are finding today's prices irresistible.

* *

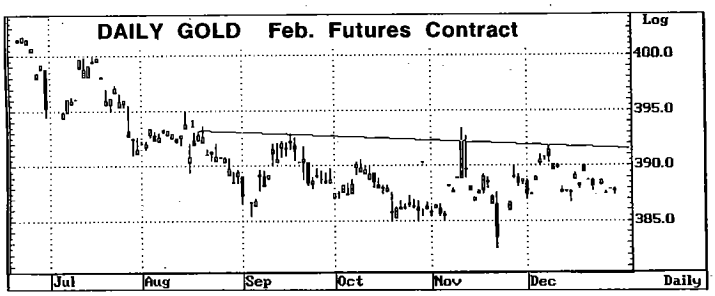
Gambling is a great occupation -- if you own a casino. But even then, nothing's guaranteed. Harrah's thought New Orleans was ripe for action. They set out to build a huge land-based casino. But a few weeks ago the New Orleans Harrah's filed for Chapter 11 bankruptcy, and the casino was left unfinished. New problem, it will cost around $25 million to close the half-built casino down and seal it off from deterioration. Ah well, it seems tourists go to New Orleans to eat, to march around the French Quarter and to see the sights. They don't go to the Big Easy to gamble.

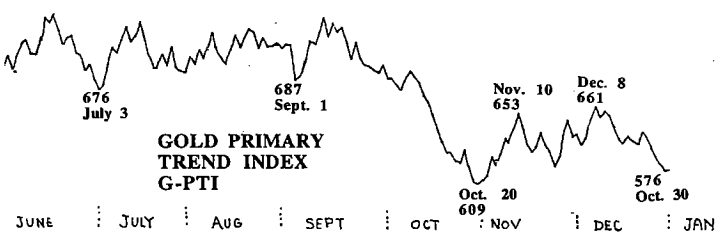
* *

We're experiencing one of the great grain and corn markets of recent history. It's a "demand bull market," meaning that demand is literally overpowering supply. In fact, the way things are going, there may be an actual world shortage of corn (see chart below). Corn, say the pros, will keep rising in price until farmers opt to kill their cattle rather than feed them super-high priced corn. Meanwhile, Russia is having its worst food-harvest in three decades, with total supply dropping from 120-130 million tons to an estimated disastrous 65-66 million tons. South Africa isi also having a bad year, due to a terrific drought.



GOLD: What's happening in the world of precious metals? Silver's acting weak. Platinum (having broken below 400 on the January contract) is also weak. Gold is "nowhere" or I guess you could say it's "just hanging on." The accompanying chart shows daily gold basis the February futures contract. The horizontal line on the chart identifies the upside resistance level; it failed, and the metal sold off to the 387 area. It's remarkable that with world gold usage (for fabrication and jewelry) at record high levels, the metal has done so little.

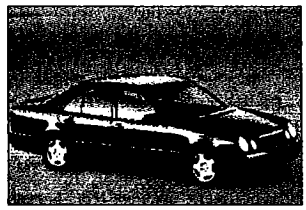




My **Gold-Primary Trend Index** tells the same story. If there's any real strength here, I don't see it. Any and all attempts at upside breakouts have been turned back. You and I may distrust paper "money," but it's obvious that most of the world's populace continues to trust the fiat money that governments manufacture.

Well, that's not entirely true. For instance, behind Europe's drive for a single currency lies Europe's desire for an *alternative to the dollar*. The central banks of the major European nations are overly-stocked with dollar reserves. And year after year they've watched the international value of those dollars decline. The Europeans would like their own currency, particularly a currency managed by Germany's powerful and conservative Bundesbank.

Right now, despite the fact that they are extremely "overpriced," the Swiss franc and the D-mark continue to be strong (against both the dollar and the yen). And amazingly, despite the "expensive" mark, German exports are at record levels. As an interesting aside on German exports, "Motor Trends" magazine voted the new Mercedes E class car the best of the year's imports. You can believe it -- the Mercedes E's are fabulous cars (I wrote in a previous Letter that I thought the "single best car buy" was a used low-mileage 300E. I drive an '87 300E and it's a prize.



Mercedes-Benz

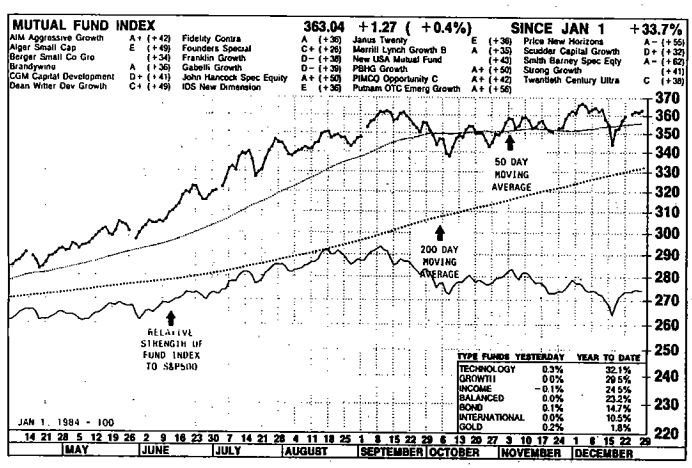
Import Car of the Year: Mercedes-Benz's all-new E-Class sedan.

BENZ WINS: The Mercedes-Benz E-Class won *Motor Trend*'s 1996 Import Car of the Year Award. The magazine praised E-Class for its "world-class quality, leading-edge technology, fresh styling, impressive power trains and outstanding value."

LATE NOTES: The consensus thinking among US economists runs as follows: "The economy will be OK but rather sluggish in '96 and therefore lower interest rates and a higher bond market are almost guaranteed. The stock market may calm down a bit, but the trend, nevertheless will continue bullish." Of fifty economists listed in the Dec. 29 *WSJ,* not one foresaw a recession in '96. Now there's fuel for a cross-up.

Going back to 1885, there have been 31 Januarys that have led to trouble in the stock market. But we haven't had a rotten January since 1984, which is amazing. It also tells us that one is overdue.

Last November (latest statistics) the public poured money (net purchases over sales) into the equity mutual funds in the monster amount of $14.5 billion. The public's faith in, and thirst for, stocks continues to be enormous. In view of this, however, it's interesting to note that the average growth-mutual-fund has not make any important progress since last September. This is documented in this chart of Investor's Business Daily Mutual Fund Index.



"A monk asked Chao-Chou, 'If a poor man comes, what should one give him?'
'He lacks nothing,' answered the Master" -- from Zen Mondo. (Russell translation: God gives us what we need, not what we want).

"Do not seek to follow in the footsteps of the wise. Seek what they sought." ... from Basho.

This year will mark my 38th year writing Dow Theory Letters. During those 38 years I've seen bull markets and bear markets, I've seen my kids grow up (although one is just starting high school and one is just heading for college and two others have produced five grandchildren). I've seen the US's population boom, and I've seen the Dow go from 200 to 5,000. I've seen a lot of my friends in the letter-writing business either retire or ascend to that great writing-desk in the sky. I'm still going strong, and I even started a new business this year. My best to all my loyal subscribers, many of whom have been with me since the '50s. Happy New Year. One last thought and prediction -- the *operative word* into the foreseeable future is going to be -- INCOME.

I'm adding these two extra pages (7 and 8) which will include my piece on the ideal business. A lot of my subscribers will be changing jobs or starting new businesses in 1996, and I thought this would be a good time to include this piece. I'll admit that this mailing makes for a lot of reading. But please don't complain -- remember, it's a lot more work writing these eight pages than reading them.

AH PERFECTION: Strange, but the most popular, the most widely-requested, and the most widely quoted piece I've ever written was not about the stock market -- it was about business, and specifically about what I call the theoretical "ideal business." I first published this piece in the early-1970s. I repeated it in Letter 881 and then again in Letter 982. I've added a few thoughts in each successive edition. But seldom does a month go by when I don't get requests from subscribers or from some publication or corporation to republish "the ideal business." So here it is again -- with a few added comments.

I once asked a friend, a prominent New York corporate lawyer, "Dave, in all your years of experience, what was the single best business you've ever come across?" Without hesitation, Dave answered, "I have a client whose sole business is manufacturing a chemical that is critical in making synthetic rubber. This chemical is used in very small quantities in rubber manufacturing, but it is absolutely essential and can be used in only super-refined form.

"My client is the only one who manufactures this chemical. He therefore owns a virtual monopoly since this chemical is extremely difficult to manufacture and not enough of it is used to warrant another company competing with him. Furthermore, since the rubber companies need only small quantities of this chemical, they don't particularly care what they pay for it -- as long as it meets their very demanding specifications. My client is a millionaire many times over, and his business is the best I've ever come across." I was fascinated by the lawyer's story, and I never forgot it.

When I was a young man and just out of college my father gave me a few words of advice. Dad had loads of experience; he had been in the paper manufacturing business; he had been assistant to Mr. Sam Bloomingdale (of Bloomingdale's Department store); he had been in construction (he was a civil engineer); and he was also an expert in real estate management.

Here's what my dad told me: "Richard, stay out of the retail business. The hours are too long, and you're dealing with every darn variable under the sun. Stay out of real estate; when hard times arrive real estate comes to a dead stop and then it collapses. Furthermore, real estate is illiquid. When the collapse comes, you can't unload. Get into manufacturing; make something people can use. And make something that you can sell to the world. But Richard, my boy, if you're really serious about making money, get into the money business. It's clean, you can use your brains, you can get rid of your inventory and your mistakes in 30 seconds, and your product, money, never goes out of fashion."

So much for my father's wisdom (which was obviously tainted by the Great Depression). But Dad was a very wise man. For my own part, I've been in a number of businesses -- from textile designing to advertising to book publishing to owning a night club to the investment advisory business (and I'm now in a new business, which I've invited subscribers to find out about).

It's said that every business needs (1) a dreamer, (2) a businessman, and (3) a S.O.B. Well, I don't know about number 3, but most successful businesses do have a number 3 or all too often they seem to have a combined number 2 and number 3.

Bill Gates is known as "America's richest man." Bully for Billy. But do you know what Gates' biggest coup was? When Gates was dealing with IBM, Big Blue needed an operating system for their computer. Gates didn't have one, but he knew where to find one. A little outfit in Seattle had one. Gates bought the system for a mere $50,000 and presented it to IBM. That was the beginning of Microsoft's rise to power. **Lesson:** It's not enough to have the product, you have to know and understand your market. Gates didn't have the product, but he knew the market -- and he knew where to acquire the product.

Apple had by far the best product in the Mac. But Apple made a monumental mistake. They refused to license ALL PC manufacturers to use the Mac operating system. If they had, Apple today could be Microsoft, and Gates would still be trying to come out with something useful (the fact is Microsoft has been a follower and a great marketer, not an innovator). "Find a need and fill it," runs the old adage. Maybe today they should change that to, "Dream up a need and fill it." That's what has happened in the world of computers. And it will happen again and again.

All right, let's return to that wonderful world of perfection. I spent a lot of time and thought in working up the criteria for what I've termed the IDEAL BUSINESS. Now obviously, the ideal business doesn't exist and probably never will. But if you're about to start a business or join someone else's business or if you want to buy a business, the following list may help you. The more of these criteria that you can apply to your new business or new job, the better off you'll be.

(1) The ideal business sells the world, rather than a single neighborhood or even a single city or state. In other words, it has an unlimited global market (and today this is more important than ever, since world markets have now opened up to an extent unparalleled in my lifetime). By the way, how many times have you seen a retail store that has been doing well for years -- then another bigger and better retail store moves nearby, and it's kaput for the first store.

(2) The ideal business offers a product which enjoys an "inelastic" demand. Inelastic refers to a product that people need or desire -- almost regardless of price.

(3) The ideal business sells a product which cannot be easily substituted or copied. This means that the product is an original or at least it's something that can be copyrighted or patented.

(4) The ideal business has minimal labor requirements (the fewer personnel, the better). Today's example of this is the much-talked about "virtual corporation." The virtual corporation may consist of an office with three executives, where literally all manufacturing and services are farmed out to other companies.

(5) The ideal business enjoys low overhead. It does not need an expensive location; it does not need large amounts of electricity, advertising, legal advice, high-priced employees, large inventory, etc.

(6) The ideal business does not require big cash outlays or major investments in equipment. In other words, it does not tie up your capital (incidentally, one of the major reasons for new-business failure is under-capitalization).

(7) The ideal business enjoys cash billings. In other words, it does not tie up your capital with lengthy or complex credit terms.

(8) The ideal business is relatively free of all kinds of government and industry regulations and strictures (and if you're now in your own business, you most definitely know what I mean with this one).

(9) The ideal business is portable or easily moveable. This means that you can take your business (and yourself) anywhere you want -- Nevada, Florida, Texas, Washington, S. Dakota (none have state income taxes) or hey, maybe even Monte Carlo or Switzerland or the south of France.

(10) Here's a crucial one that's often overlooked; the ideal business satisfies your intellectual (and often emotional) needs. There's nothing like being fascinated with what you're doing. When that happens, you're not working, you're having fun.

(11) The ideal business leaves you with free time. In other words, it doesn't require your labor and attention 12, 16 or 18 hours a day (my lawyer wife, who leaves the house at 6:30 AM and comes home at 6:30 PM and often later, has been well aware of this one).

(12) Super-important: the ideal business is one in which your income is not limited by your personal output (lawyers and doctors have this problem). No, in the ideal business you can sell 10,000 customers as easily as you sell one (publishing is an example).

That's it. If you use this list it may help you cut through a lot of nonsense and hypocrisy and wishes and dreams regarding what you are looking for in life and in your work. None of us own or work at the ideal business. But it's helpful knowing what we're looking for and dealing with. As a buddy of mine once put it, "I can't lay an egg and I can't cook, but I know what a great omelet looks like and tastes like."

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"Work is love made visible. And if you cannot work with love, but only with distaste, it is better that you leave your work and sit at the gate of the temple and take alms from those who work with joy." -- Kahlil Gibran

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Albert Einstein's three rules of work:
(1) Out of clutter find simplicity.
(2) From discord find harmony.
(3) In the middle of difficulty find opportunity.

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